

What a client needs to know about IR35

Having an understanding of **IR35 tax law** will help you recruit the best contractors, particularly if you are supportive of their need to have some elements of their contract amended, or help them provide evidence, should it be required, that they are not what the taxman sees as a **'disguised employee'**.

But what exactly is **IR35** and why are contractors so passionate about it? IR35 is a piece of tax legislation that was introduced in 2000 by the then Chancellor, Gordon Brown. It enables **HMRC** to tax contractors as if they are 'disguised employees', and not independent service companies. The result is that, by falling inside IR35, contractors pay much more tax and have a **significantly reduced take-home pay**.

Clients are not directly affected by IR35. However, IR35 is hugely important to contractors and can massively impact on how much they earn and how they work. Contractors can also be targeted by HMRC for investigations that can cost thousands in professional defence fees.

So, although there is no legal or tax reason for clients to understand and accommodate IR35, they should have a basic knowledge of it. Contractors will almost certainly ask for changes to contracts, specific working practices and for various documents to be signed, so a client who understands why can manage their contractors and their demands more effectively.

How does IR35 work?

Basically, IR35 says that if a worker acts like an employee, then they should be taxed like an employee, irrespective of whether they are working through their own **contractor limited company**.

However, clients should not be concerned; a contractor whose contract is caught by IR35 and pays tax like an employee does not receive employment rights like an employee – that's one reason why some contractors dislike the legislation so much.

So why should clients be bothered about IR35 at all? Well, mainly because their contractors have to worry about three things that will contribute towards determining their employment status, and therefore whether or not they are inside IR35:

Any contract between some or all of the following – the contractor, the agency, the client

The contractor's business as a whole; whether they look like they are running a proper business

The actual on-site day-to-day working relationship between the contractor and the client.

Clients can have an impact on points one and three, and will find that contractors want to make changes to written contracts and clearly establish the day-to-day relationship with the client in writing. That's why clients should be bothered about IR35.

'IR35 friendly' contracts

Although what's in the contract is only part of how a contractor is evaluated by HMRC for IR35, the first contact most clients will have with the tax law is when the contractor starts asking for amendments to the client's standard contract.

This is a judgement call. The client project manager may find their colleagues in the finance department highly unsympathetic to any deviations from the norm, but equally may find it difficult recruiting and keeping good contractors if they want contracts which are full of IR35-unfriendly clauses.

Clients can expect a contractor, or their legal representative, to be asking for changes that:

Show that the client does not 'control' the contractor

Say the contractor can use a substitute, which the client has no power to vet

Clearly state that there is no 'mutuality of obligation', which is a classic test of employment

Does not require the contractor to work on-site, although there may be practical issues like access to vital systems of equipment

Show the contractor is not required to work specific hours.

Clients should not be alarmed about these requests, as they are not an attempt by the contractor to shirk their responsibilities or get one over on the client; but merely to keep the contractor outside of IR35.

'Confirmation of arrangements'

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Once recruited and with their IR35 friendly contract signed and sealed, the contractor is next likely to ask the client to sign a '[confirmation of arrangements](#)'. This is simply an attempt by the contractor to record for posterity, and their records, the exact nature of the working relationship between them and their client.

It's likely to say things like:

The contractor is required to sign-in every day

The contractor is not allowed to use subsidised staff facilities, like canteens and gyms

The contractor works regular hours for the convenience of and out of professional courtesy for their client, but does not have to

The contractor can work from their own office at times, which may be a home office

The contractor determines how to do the work on the project they are contracted to complete and are not told to do so by the client

The contractor will only perform duties consistent with the contract, and will not take on any old job that needs doing or that they're instructed to do

The contractor can use subcontractors to perform aspects of the job, if they wish to

The contractor can send in another contractor in their place.

Of course, the client should only sign a statement that truthfully reflects the contractor's working arrangements. But, again, the client should read nothing sinister into any of these statements. The 'confirmation of arrangements' is simply the contractor's method of trying to clarify for the purposes of any future tax investigation exactly how they worked with their client.

Counter-signing an accurate confirmation of arrangements for a contractor during the contract might be a good strategy to avoid being called as a witness in an IR35 tax tribunal or high court appeal in the future.

What to do when called as a witness to an HMRC investigation

If a client has been managing a lot of contractors over many years, there is every possibility that one day they may be summoned to be a witness at a tax tribunal or a high court appeal for a contractor's IR35 case.

Undoubtedly, for most clients this will be a hassle, time consuming and possibly stressful, but they will have no choice but to turn-up and give evidence. However, if they have understood IR35 and what their contractors have needed from them to manage it effectively, then the process will go much more smoothly.

If the client has signed a confirmation of arrangements in the past, this may forestall the need for them to bear witness, unless a particularly bullish HMRC inspector insists. And if they have to bear witness, and there genuinely was no employment relationship, then the client's evidence should support the confirmation of arrangements and contract.

Clients don't need to have an in-depth knowledge of IR35 and where it applies, but an understanding can often explain why contractors make the requests they do.

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